

Nos. 12289-12290-12291

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*United States*  
*Court of Appeals*  
*For the Ninth Circuit*

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ESTATE OF ELLA K. McCLATCHY, ELEANOR  
McCLATCHY and CHARLOTTE MALONEY,  
Executrices,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

CHARLOTTE MALONEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ELEANOR McCLATCHY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

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*Petitioners' Brief*

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Upon Petitions to Review Decisions of the Tax Court  
of the United States.

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# Petitioners' Brief

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## Appearances

For Petitioners:

JOHN J. HAMLYN

WENTWORTH L. KILGORE

For Respondent:

THERON L. CAUDLE

CHARLES OLIPHANT

## Statement of Pleadings and Jurisdiction

The above consolidated cases were instituted by the filing in the Tax Court of the United States, (hereinafter referred to as the Tax Court for the purpose of brevity), pursuant to section 272 (a), (1) of the Internal Revenue Code, of petitions for re-determination of the respective deficiencies determined by Respondent specified in the Stipulation of Facts filed in said court, appearing on page 23 of the Transcript of Record herein. The Tax Court, upon consideration of the pleadings, stipulation of facts and briefs, entered its respective decisions (pages said determinations of deficiencies by Respondent. Petitions for a review of said decisions were filed in this court pursuant to section 1142 of the Internal Revenue Code, which provides that the Court of Appeals for the circuit wherein the office of the Collector of Internal Revenue is located (where the taxpayer files his return), shall have jurisdiction to review a decision of the Tax Court. Petitioners filed their returns with the Collector of Internal Revenue at San Francisco, California, within the Ninth Judicial Circuit.

## Statement Of Case

The Commissioner of Internal Revenue determined the following deficiencies against petitioner:

Petitioner	Income Tax	Income and Victory
	1942	Tax, 1943
1. Estate of Ella K. McClatchy .....	\$8,639.98	\$1,731.25
2. Charlotte Maloney .....		213.54
3. Eleanor McClatchy .....		2,904.43



The year 1942 is involved in deficiencies numbered 2 and 3 above by reason of the Current Tax Payment Act of 1943.

Petitioners claimed deductions in the year 1942 for payments of income taxes in that year to the State of California, said income taxes having been assessed against Charles K. McClatchy and Ella K. McClatchy, both deceased. These deductions were disallowed by Respondent.

Petitioner Estate of Ella K. McClatchy also claimed deduction of interest paid to the State of California on an inheritance tax deficiency assessed by said state.

An issue as to dividends received was raised originally by Petitioners, but is not raised by them with respect to this review.

Petitioners, Charlotte Maloney and Eleanor McClatchy, are the beneficiaries of two of the three trusts created by Charles K. McClatchy, who died April 27, 1936, known as Trusts Nos. 1 and 2, respectively, each trust receiving one-third of his estate. They are also the executrices of the Estate of Ella K. McClatchy, who died September 23, 1939, one of the Appellants in this cause. The tax returns involved were all filed with the collector for the First District of California at San Francisco.

After the respective deaths of said decedents, the Franchise Tax Commissioner of the State of California, pursuant to section 34 of the Personal Income Tax Act of 1935 assessed additional state income taxes against Charles K. McClatchy and Ella K. McClatchy, as follows:

Date of Assessment	Charles K. McClatchy Taxpayer	Ella K. McClatchy Amount	Taxable Period Ended Dec. 31
Jan. 23, 1939 .....	\$1,791.64	\$1,797.05	1935
Apr. 1, 1940 .....	2,170.44	5,317.17	1936
Totals .....	\$3,962.08	\$7,114.22	

Payment of these taxes was protested and withheld pending the determination of the constitutionality of section 34 of the California Personal Income Tax Act of 1935.

On March 7, 1941, the Supreme Court of California determined that section 34 was constitutional. Payment on behalf of the two decedents was made on May 5, 1942 as follows:

Decedent	Deficiency	Interest	Paid by	Amount
Charles K. McClatchy .....	\$3,932.08	\$1,309.33	Trust No. 1	\$1,747.14
			Trust No. 2	1,747.14
			Trust No. 3	1,747.14
Ella K. McClatchy .....	7,110.22	2,264.59	Total .....	\$5,241.42
			Estate .....	9,374.81

No claim for the deduction of the taxes in question, assessed against Charles K. McClatchy and paid by the three testamentary trusts, was made in that decedent's final Federal income tax returns, filed March 15, 1937, or in said decedent's Federal estate tax return, which was filed July 24, 1937, and finally settled May 14, 1940. Deductions on account of the payment of these taxes plus interest were taken in 1942 by the parties paying them in that year.

The Commissioner increased the income distributable to petitioners Eleanor McClatchy and Char-



lotte Maloney from the Charles K. McClatchy Trusts Nos. 1 and 2, respectively, in the amount of \$1,747.14, each for the year 1942.

No consents or waivers were filed pursuant to section 134 of the 1942 Revenue Act or section 126 of the Internal Revenue Code, and the appropriate Regulations.

The Commissioner allowed the Estate of Ella K. McClatchy a deduction for 1942 Federal income tax purposes of \$1,113.92, representing interest on the state income tax deficiency accrued since the death of said Ella K. McClatchy. The deduction of the \$7,110.22 state income tax and \$1,150.67 of the total interest thereon was disallowed.

Section 34 of the California Personal Income Tax Act of 1935 was repealed in 1937.

In December, 1942, the State Franchise Tax Commissioner assessed additional deficiencies in income tax against Ella K. McClatchy as follows:

Taxable Year	Tax	Interest	Total
1938 .....	\$271.42	\$ 63.85	\$335.27
1939 .....	543.40	101 03	644.43
Totals .....	\$814.82	\$164.88	\$979.70

These amounts were paid by the estate and claimed as a deduction in 1943. The Commissioner disallowed the deduction of the state income taxes in the total amount of \$814.82 and \$7.22 of the interest that had accrued before the death of Ella K. McClatchy.

Ella K. McClatchy's final Federal income tax return covering the year 1939 up to the time of her

death was filed March 15, 1940. On October 9, 1945, the estate filed a claim for refund of income taxes allegedly overpaid in the amount of \$5,788.28 for the year 1939. The refund was denied January 6, 1947. Her Federal estate tax return was filed December 20, 1940, and a closing agreement was effected June 11, 1942. The deductions in question were not taken in either the final income tax return or the estate tax return. No waivers or consents were filed pursuant to section 134 (g) of the Revenue Act of 1942 or section 126 of the Internal Revenue Code and the applicable regulations.

In December, 1943, additional California inheritance taxes of \$5,304.41, plus interest of \$2,223.41, were assessed and paid in 1943 in connection with the Estate of Ella K. McClatchy. The beneficiaries of the Charles K. McClatchy trusts were also the beneficiaries of three trusts created by the last will of Ella K. McClatchy. The tax and interest were paid by the McClatchy Newspapers and charged against the three testamentary trusts of Charles K. McClatchy. The three trusts claimed a deduction of the interest in their returns for 1943 which was disallowed by the Commissioner.

On June 1, 1944, the petitioner estate contended that the payments were improperly made by the trusts, and accordingly the McClatchy Newspapers corrected these charges on their books and showed them made against petitioner estate. The estate now claims the deduction for 1943 of the interest

on the inheritance taxes. No other claim for the interest deduction has been allowed.

The returns in question were filed on the cash receipts and disbursement basis.

### Specification Of Errors

1. The Tax Court erred in sustaining the respective deficiencies asserted by Respondent.

2. The Tax Court erred in sustaining the disallowance by Respondent of the deductions claimed by Petitioners for payment of additional California state income taxes assessed in 1939 and 1940 against Charles K. McClatchy and Ella K. McClatchy, both deceased, for the taxable years 1935 and 1936, respectively in the amounts above set forth.

3. The Tax Court erred in affirming the disallowance by Respondent of the item of interest on the California state inheritance tax deficiency assessed against the Estate of Ella K. McClatchy, deceased.

### Argument

The questions of law involved in the above case are fourfold:

1. Whether or not the additional state income taxes assessed against the two decedents above named had accrued prior to March 7, 1941, the date on which the Supreme Court of California determined that section 34 of the California Personal Income Tax Act of 1935 was constitutional, pay-

ment of said taxes having been made in 1942 and deduction claimed for that year.

2. Whether or not consents or waivers were required of Petitioners under section 134 (g) of the Revenue Act of 1942 or section 126 of the Internal Revenue Code and appropriate regulations.

3. Whether or not the interest on the California inheritance tax deficiency assessed against the Estate of Ella K. McClatchy was a deductible item under the Internal Revenue Code.

4. Whether or not the running of the time of limitation provided by section 322(b) of the Internal Revenue Code together with the determination of the Tax Court, gives Petitioners a remedy to claim the deductions nevertheless under section 3801 of the Internal Revenue Code.

1. **Accrual of State Taxes.** It is the contention of Petitioners in this cause that the additional California state income taxes did not accrue until March 7, 1941, the date the state Supreme Court declared constitutional section 34 of the Personal Income Tax Act, the section upon the authority of which such taxes were levied. (Page 24, Transcript of Record).

The Board of Tax Appeals decided in the case of **J. A. Dougherty's Sons**, 42 B.T.A. 892 that the taxes involved therein had not accrued because the statute under which such taxes were levied was contested and was later declared unconstitutional. Previously, the same board had stated, (**Central National Bank of Cleveland v. Commissioner**, 35 B.T.A. 489)



that no basis for accrual existed in the matter of interest claimed on the final return of a decedent if "the events fixing the liability did not transpire until after the decedent's death."

The rule was applied to a case involving the deduction for expenses incurred in settling litigated claims against a decedent in **Estate of Lambert**, 40 B.T.A., 802. Here the Revenue Act of 1934 governed, the deduction having been claimed under section 43. The actions on the claims were not begun until after decedents' death, but they were based upon transactions occurring prior thereto. The amounts due the claimants were not liquidated until almost two years after his death. The Board of Tax Appeals held that there was no basis for accrual of the items, since in no case was decedent's liability fixed and determined before his demise. Thus the contested payments for expenses were not accrued up to the date of death within the meaning of the statute.

It is true there was a conflict of authority as between different circuits of the Court of Appeal following the **J. A. Dougherty's Sons** case, but the United States Supreme Court, in **Dixie Pine Products Company v. Commissioner**, 320 U. S. 516, 64 Sup. Ct. 364, pointing out the existence of the conflict, and taking the case to clarify the law, held that a state tax, the payment of which has been protested, and liability for which is denied, does not accrue until the fact of liability becomes fixed and certain. The court said that the taxpayer on

the accrual basis could not deduct the payment of a state tax which he is contesting in the state courts until the liability is fixed.

Petitioners submit that the **Dixie Pine Products Company** case did not establish a new rule, but that it merely reaffirmed what the rule actually was, as declared by the Board of Tax Appeals in the **J. A. Dougherty's Sons** case and other decisions. It merely decided that the theory underlying the decisions exemplified by **Commissioner v. Central United National Bank**, (1938), 99 Fed. (2d.) 568, was erroneous. The Supreme Court decision in the **Dixie Pine Products Company** case reaffirmed the principles of the holding in **Brown v. Helvering**, 291 U. S. 193, 54 Sup. Ct. 356, that truly contingent liabilities do not accrue for income tax purposes and may not be deducted as accrued. The rule was later affirmed by the Supreme Court in **Security Flour Mills Company v. Commissioner**, 321 U. S. 281, 64 Sup. Ct. 596.

In **Commissioner v. U. S. Trust Company**, 143 Fed.

(2d) 243, the court suggested that, with respect to contingent and undetermined liabilities, it makes no difference whether the taxpayer is on the cash or the accrual basis. (On accrual of tax, see also: **The Baltimore and Ohio Railroad Co. v. Magruder**, 77 Fed. Supp. 156; **Burton-Sutton Oil Company v. Commissioner**, 3 T. C. 1187; **Street & Smith Publications, Inc. v. U. S.**, 38 Fed. Supp. 461; and **William Justin Petit**, 8 T. C. 228.)

Applying this rule to the instant case, the addi-



tional state income taxes which, it should be noted, were assessed against the two taxpayers **after their deaths**, did not accrue until March 7, 1941, when the validity of the contested tax was finally determined. Petitioners claimed deductions for the taxes for the years when paid. At the time Respondent assessed the deficiencies involved in the instant cases, Petitioners were foreclosed by the statute of limitations (section 322 (b), Internal Revenue Code) from filing amended final income tax returns for said decedents, or either of them, and Petitioners, by reason of the disallowance by Respondent, have been unjustly deprived of any deduction for the state tax payments which would otherwise be clearly deductible under section 23, Internal Revenue Code. The injustice of such a result is manifest.

2. **Waivers or consents.** Petitioners were not required to file waivers or consents under section 126 Internal Revenue Code (section 134 (g), Revenue Act of 1942). The final Federal income tax return of Charles K. McClatchy was filed on March 15, 1937, before any additional state income tax was assessed against him. (Page 30, Transcript of Record). The final Federal income tax return of Ella K. McClatchy was filed on March 15, 1940, about a year prior to the determination that the state tax was valid. (Page 30, Transcript of Record). By reason of the delayed accrual of these state taxes, there was nothing for Petitioners to waive until the taxes did accrue. A taxpayer cannot waive a credit for a tax levy which legally does not exist. Since the taxes had not accrued, Petitioners were not entitled

to waive them with respect to the final Federal income tax returns of the respective decedents. It is apparent that Congress, in enacting section 134 (g), intended that the taxpayer be required to waive a presently existing right, not one which comes into existence, if at all, at a later date. By the time Petitioners were in a position to claim any deduction at all for the state taxes, the Statute of Limitations had foreclosed them from claiming credit therefor in the final income tax returns of the respective decedents.

With respect to the Federal estate tax of each decedent, Petitioners submit that the filing of consents or waivers under section 134 (g) of the Revenue Act of 1942 was neither required nor in order, in view of the fact that the state taxes had not accrued prior to death, under the doctrine of the **Dixie Pine Products Company** case. Consents of this kind, insofar as they waive a right to deduction for purpose of Federal estate tax are manifestly required only where the amounts which would otherwise be claimed as deductions from said tax have accrued as a liability of the decedent **prior to his death**. In the instant case, as noted above, the additional state income taxes did not accrue (in fact they were not even levied in the first instance) prior to the death of either decedent. Such taxes were therefore not a legal charge against either estate, and there was absolutely nothing for Petitioners to waive.

In the case of **Estate of Ingraham**, 8 T. C. 701,

the Tax Court held that the filing of consents under section 134 (g) of the 1942 Act was required in the case of an estate. However, it should be noted that the testator had died on June 26, 1942, and the estate had failed to file consents for the deduction of dividends and interest which had accrued **prior to the death** of the decedent, Ingraham.

**3. Deduction for Interest on Additional Inheritance Tax.** Petitioner Estate of Ella K. McClatchy should be allowed the claimed deduction for interest amounting to \$2,223.41 on the additional inheritance tax paid by McClatchy Newspapers and erroneously charged to the Charles K. McClatchy trusts, and later corrected so as to charge the appellant estate. (Page 27, Transcript of Record.)

Under section 14101 of the California Revenue and Taxation Code, the executor or administrator is specifically made liable for the payment of the tax, and liability continues until that tax is paid. Section 14121 of the same code provides that he must deduct the amount of the tax from each share to be distributed and is not required to distribute any share until the tax is deducted or collected. The California Supreme Court has said that the personal representative is primarily liable for the payment of the tax and it is chargeable against the money and other property of the estate in his hands. **Cohn, v. Cohn**, 20 Cal. 2d. 65, 123 P. (2d), 833.

**4. Statutory Relief.** Petitioners are entitled to relief from the injustice resulting from the disallow-

ance of their claimed deductions and the running of the Statute of Limitations, by reason of section 3801, Internal Revenue Code, which was enacted for the purpose of relieving a taxpayer from a determination such as the decisions of the Tax Court in this case.

Respectfully submitted,  
JOHN J. HAMLYN,  
Attorney for Petitioners.

WENTWORTH L. KILGORE,  
Of Counsel for Petitioners.